tax rate overview

The effective rate of federal tax on income ranges from 0% to 56%.

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As a result of the American Taxpayer Relief Act of 2019 ("ATRA"), the Bush-era tax cuts were extended and made permanent for married taxpayers with taxable income below $466,950 in 2016 ($470,700 in 2017) and single taxpayers with income below $415,050 in 2016 ($418,400 in 2017). These amounts will be adjusted for inflation in the future.

The rate of tax you pay on your income — as well as the benefit you receive from your deductions — can vary from no tax at all to a rate of approximately 56% depending on many factors, including:

- What is the nature of your income? Is it ordinary income, qualifying dividend income or net long-term capital gain income?
- Are you losing the advantage of the lower long-term capital gains rate because of netting rules?
- Are you subject to the AMT?
- Are you subject to the Medicare Contribution Tax on net investment income?
- Are you subject to the Medicare Wage Surcharge?
- Is any of your income subject to self-employment tax?
- How much of your miscellaneous itemized deductions and total itemized deductions are being limited?
- Are your personal exemptions being phased out?
- Is any of your income eligible to be excluded from your taxable base?
- Are credits available to offset your tax?

The most common federal tax rates (exclusive of the Medicare Contribution Tax on net investment income) are:

- 20% for net long-term capital gains and qualified dividends for taxpayers in the 39.6% tax bracket, such as for married taxpayers with 2016 taxable income over $466,950 ($415,050 for single filers).
- 28% for ordinary income subject to the AMT.
- For 2016, 39.6% maximum rate for ordinary income, including short-term capital gains for married taxpayers with taxable income over $466,950 ($470,700 in 2017) and $415,050 for single filers ($418,400 in 2017).
- The top rate for the first $118,500 of wages earned in 2016 ($127,200 in 2017) is approximately 48% and 56% for self-employment income. The portion of Social Security FICA tax that employees pay remains unchanged at 6.2% on the first income listed herein (12.4% for self-employed individuals). The Medicare portion of the FICA tax remains unchanged at 1.45% on all income earned for employees. For the self-employed, the rate is 2.9% of all self-employment income. Also, there is the additional 0.9% additional Medicare tax paid by those earning more than $200,000 ($250,000 for married taxpayers and $125,000 for married taxpayers filing separately).

ORDINARY INCOME RATES

Ordinary income primarily includes wages, business and self-employment income, interest income, nonqualifying dividend income, taxable retirement plan distributions, rental income, taxable Social Security benefits, alimony, and your distributive share of ordinary income passing through to you from a partnership, LLC or S corporation.

Net short-term capital gains are subject to the same rate as ordinary income and, therefore, could be taxed at a rate as high as 43.4%, inclusive of the Medicare Contribution Tax on net investment income. Chart 1 shows the different tax brackets that apply to ordinary income in 2016 and 2017 for married filing jointly and single taxpayers.

CAPITAL GAIN AND DIVIDEND INCOME RATES

Long-term capital gains and qualified dividend income are eligible to be taxed at lower maximum tax rates than ordinary income. This is discussed in detail in the chapter on capital gains and losses. But here are the basic rules:

Net long-term capital gains are taxed at a maximum rate of 20% (if your taxable income exceeds certain thresholds) for both the regular tax and the AMT — with several notable exceptions to be discussed in the chapter on capital gains and losses. In some cases, the former 15% rate may still apply. To benefit from long-term capital gains treatment, you must have held the asset for more than 12 months. There is an additional 3.8% Medicare Contribution Tax on net investment income, including net long-term capital gains.

For 2016, dividends received from most domestic corporations and qualified foreign corporations are taxed at the same 15% rate that applies to net long-term capital gains (20% for married taxpayers with taxable income over $466,950 ($470,700 in 2017) and $415,050 ($418,400 in 2017) for single filers). Dividends that do not qualify for the preferential rate of 15% (or 20%), such as dividends from a money market fund or nonqualified foreign corporations, are subject to the higher ordinary income tax rates. There is an additional 3.8% Medicare Contribution Tax on net investment income that will also apply to dividend income.

chart 1

2016 AND 2017 FEDERAL TAX RATE SCHEDULES

2016 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
18,550	1,855.00	15%
75,300	10,367.50	25%
151,900	29,517.50	28%
231,450	51,791.50	33%
413,350	111,818.50	35%
466,950	130,578.50	39.6%
Single		
$ 0	$ 0	10%
9,275	927.50	15%
37,650	5,183.75	25%
91,150	18,558.75	28%
190,150	46,278.75	33%
413,350	119,934.75	35%
415,050	120,529.75	39.6%

2017 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
18,650	1,865.00	15%
75,900	10,452.50	25%
153,100	29,752.50	28%
233,350	52,222.50	33%
416,700	112,728.00	35%
470,700	131,628.00	39.6%
Single		
$ 0	$ 0	10%
9,325	932.50	15%
37,950	5,226.25	25%
91,900	18,713.75	28%
191,650	46,643.75	33%
416,700	120,910.25	35%
418,400	121,505.25	39.6%

Note: *See Appendix B for detailed 2016 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household. See Appendix C for detailed 2017 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household.*

ALTERNATIVE MINIMUM TAX

Ordinary income subject to the AMT is taxed at a maximum rate of 28%. As mentioned above, the 15% or 20% rate on net long-term capital gains and qualified dividends also applies to the AMT. While the AMT rate on ordinary income is lower than the highest regular tax rate of 39.6%, it usually applies to a higher taxable income base and frequently results in a greater tax. This is especially true if you live in a state with high income tax rates and high real estate taxes, and/or you have significant investment expenses in excess of 2% of your AGI, since these deductions are not allowed in computing your AMT. See the chapter on the AMT for a more detailed discussion.

KIDDIE TAX

The unearned income of a child under age 19, or a full-time student under age 24, is generally taxed at the parents' tax rate. This is designed to lessen the effectiveness of intra-family transfers of income-producing property that would shift income from the parents' higher marginal tax rate to the child's generally lower tax rate. For 2016 and 2017, the first $1,050 of the child's unearned income is tax-free. The next $1,050 for 2016 (and 2017) is taxed at the child's marginal rate. Any excess of unearned income above $2,100 is then taxed at the parents' marginal rate (assuming the parents' rate is higher than the child's). To the extent that the child has earned income such as wages, that income is taxed at the child's marginal rate. Unearned income such as net long-term capital gains and qualifying dividend income is eligible for the preferential tax rate of 15% or 20% to the extent that rate applies to the parents' income. The child may also be subject to the Medicare Contribution Tax on net investment income (see below).

EMPLOYMENT TAXES

Your wages and self-employment income are also subject to Social Security and Medicare taxes. The amount of income subject to the Social Security tax is limited (see Chart 2), but all earned income is subject to the Medicare Contribution Tax.

If you are self-employed, your share of Social Security and Medicare taxes almost doubles because you pay both the employer's and employee's portions of these taxes. As a result, for 2016, the federal effective tax rate on self-employment income can be as high as 56% on the first $118,500 of such income, compared to about 48% for income from wages (after including your employee share of Social Security and Medicare taxes). The reason there is not a greater spread is primarily because you receive a deduction against AGI for 50% of the self-employment tax you pay.

chart 2

SOCIAL SECURITY AND MEDICARE TAXES FOR 2016 AND 2017

Maximum Income Subject to Tax			Tax Rates/Maximum Tax Cost	
			Employer and Employee Portion	**Self-Employed**
Social Security	**2016**	$118,500	6.2%/$7,347 each	12.4%/$14,694
	2017	$127,200	6.2%/$7,886.40 each	12.4%/$15,772.80
Medicare	**2016**	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**
	2017	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**

** The tax rate is actually 2.9%, but only 92.35% of self-employment income is subject to the Medicare Tax.*

***Includes 0.9% Hospital Insurance Tax for amounts above certain income thresholds.*

MEDICARE WAGE SURTAX

An additional 0.9% Hospital Insurance Tax applies to earned income. This tax applies to wages and/or self-employment income in excess of $250,000 for married couples filing joint returns, $125,000 for married filing separate returns and $200,000 for all other taxpayers. The threshold amounts are not indexed for inflation.

MEDICARE CONTRIBUTION TAX ON NET INVESTMENT INCOME

The Health Care and Education Reconciliation Act of 2010 provided for a 3.8% tax on net investment income of higher income taxpayers for years beginning in 2013.

The additional 3.8% tax will apply if your AGI (with certain modifications) is in excess of $250,000 for a joint return (and qualifying widow(er) with dependent child), $200,000 if single, and $125,000 if married filing separate. The tax will apply to the lesser of your net investment income or your AGI in excess of the applicable threshold amounts stated above. Net investment income includes interest, dividends, capital gains, annuities, royalties, rents, income from passive business activities and income from trading in financial instruments or commodities. The amount of gross investment income may be reduced by expenses associated with earning that income. Such expenses include directly allocable state and local taxes, investment advisory fees (over 2% of AGI), and investment interest expenses.

The maximum federal tax rate on long-term capital gains and qualified dividends will be 23.8% (20% plus 3.8% additional Medicare Contribution Tax on net investment income). The threshold amounts are not indexed for inflation.

ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

Reduction of miscellaneous itemized deductions
You must reduce certain miscellaneous itemized deductions by 2% of your AGI. The deductions subject to the 2% disallowance include investment advisory fees, unreimbursed employee business expenses, professional dues and subscriptions, tax return preparation fees and deductible legal expenses.

Reduction of itemized deductions
For 2016, the reduction of itemized deductions affects married taxpayers with AGI over $311,300 ($313,800 in 2017) and single taxpayers with AGI over $259,400 ($261,500 in 2017). Certain itemized deductions are to be reduced by the lesser of 3% of the amount by which AGI exceeds a certain limit or 80% of the itemized deductions subject to the reduction rules.

Personal exemptions
The personal exemption amount ("PEP") for 2016 (and 2017) is $4,050 for each of your qualifying dependents. The 2016 PEP begins to phase out for married taxpayers with AGI over $311,300 ($313,800 in 2017) and single taxpayers with AGI over $259,400 ($261,500 in 2017). It completely phases out for married taxpayers at $433,800 for 2016 ($436,300 in 2017) and for single taxpayers at $381,900 for 2016 ($384,000 in 2017).

FOR 2016 AND BEYOND

PATH permanently extended the option to claim an itemized deduction for state and local general sales tax in lieu of an itemized deduction for state and local income taxes, effective for taxable years beginning after December 31, 2014. A taxpayer may either deduct the actual amount of sales tax paid in a tax year or, alternatively, deduct an amount prescribed by the IRS.